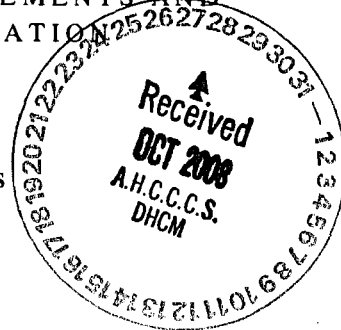


AUDITED FINANCIAL STATEMENTS AND
OTHER FINANCIAL INFORMATION

VHS Phoenix Health Plan, LLC
Year Ended June 30, 2008
With Report of Independent Auditors



Report of Independent Auditors

The Board of Directors
VHS Phoenix Health Plan, LLC

We have audited the accompanying balance sheet of VHS Phoenix Health Plan, LLC, a subsidiary of Vanguard Health Systems, Inc., as of June 30, 2008 and the related statements of earnings, member's equity and cash flows for the year then ended. These financial statements are the responsibility of VHS Phoenix Health Plan, LLC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of VHS Phoenix Health Plan, LLC's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of VHS Phoenix Health Plan, LLC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VHS Phoenix Health Plan, LLC at June 30, 2008, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The details of the attached schedules (pages 17 through 28) of other financial information are presented for purposes of additional analysis and are not a required part of the basic financial statements. The attached schedules are the responsibility of VHS Phoenix Health Plan, LLC's management. Such information has not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we express no opinion on it.

Ernst & Young LLP

September 22, 2008

VHS Phoenix Health Plan, LLC

Balance Sheet

June 30, 2008

Assets

Current assets:

Cash and cash equivalents	\$ 33,729,192
AHCCCS receivables	18,089,444
Prepaid expenses and other current assets	928,202
Due from affiliates	<u>128,863,031</u>

Total current assets 181,609,869

Property and equipment:

Furniture and equipment	2,156,716
Software	2,154,851
Construction in progress	81,165
Less: accumulated depreciation	<u>(3,100,767)</u>

Net property and equipment 1,291,965

Goodwill 79,402,908

Intangible assets, net 20,375,000

Other assets 47,928

Total assets \$ 282,727,670

Liabilities and member's equity

Current liabilities:

Accounts payable	\$ 6,950,573
Medical claims payable	49,465,831
Other accrued expenses	<u>1,634,575</u>

Total current liabilities 58,050,979

Other long-term liabilities 233,304

Member's Equity:

Member's capital	157,035,173
Retained earnings	<u>67,408,214</u>

Total member's equity 224,443,387

Total liabilities and member's equity \$ 282,727,670

See accompanying notes.

VHS Phoenix Health Plan, LLC

Statement of Earnings

Year Ended June 30, 2008

Revenues:

Capitation	\$ 306,723,665
Supplemental revenues	30,069,145
Other revenues	<u>5,656,794</u>
Total revenues	342,449,604

Expenses:

Hospital	105,636,388
Medical compensation	74,141,204
Other medical	<u>107,240,364</u>
	287,017,956
Less: reinsurance and third party liability	<u>14,369,040</u>
Total medical expenses	272,648,916
Administrative expenses	<u>27,906,947</u>
Total expenses	<u>300,555,863</u>

Earnings before premium and income taxes	41,893,741
Premium taxes	6,883,344
Income taxes	<u>12,268,732</u>
Net earnings	<u>\$ 22,741,665</u>

See accompanying notes

VHS Phoenix Health Plan, LLC

Statement of Cash Flows

Year Ended June 30, 2008

Operating activities

Net earnings	\$ 22,741,665
Adjustments to reconcile net earnings to net cash provided by operating activities:	
Depreciation and amortization	4,036,185
Changes in assets and liabilities:	
Increase in AHCCCS receivables	(5,323,410)
Increase in prepaid expenses and other current assets	(388,383)
Increase in medical claims payable	2,960,433
Increase in accounts payable	5,951,807
Increase in other accrued expenses	543,781
Decrease in other long-term liabilities	(177,811)
Net cash provided by operating activities	<u>30,344,267</u>

Investing activities

Capital expenditures	(261,926)
Increase in other assets	<u>(100)</u>
Net cash used in investing activities	(262,026)

Financing activity

Increase in due from affiliates	<u>(49,626,242)</u>
Decrease in cash and cash equivalents	(19,544,001)
Cash and cash equivalents, beginning of year	<u>53,273,193</u>
Cash and cash equivalents, end of year	<u><u>\$ 33,729,192</u></u>
Interest paid, net of interest received	<u><u>\$ 30,104</u></u>

See accompanying notes.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements

Year Ended June 30, 2008

1. Organization and Operations

VHS Phoenix Health Plan, LLC (PHP) is a wholly owned subsidiary of Abrazo Advantage Health Plan, Inc. (AAHP) and an indirect wholly owned subsidiary of Vanguard Health Systems, Inc. (Vanguard). Vanguard also operates general, acute care hospitals and related outpatient service locations complementary to the hospitals. As of June 30, 2008, Vanguard owned 15 hospitals with a total of 4,181 licensed beds in five states. Vanguard owns or maintains an interest in certain outpatient diagnostic imaging and surgery centers, clinics, managed health plans, laboratory processing companies and billing companies affiliated with the hospitals.

PHP is a prepaid Medicaid managed health plan that derives substantially all of its revenues through a contract with the Arizona Health Care Cost Containment System (AHCCCS) to provide specified health services to qualified Medicaid enrollees through contracts with providers. AHCCCS is the state agency that administers Arizona's Medicaid program. The contract requires PHP to arrange for healthcare services for enrolled Medicaid patients in exchange for fixed monthly premiums, based on negotiated per capita member rates, reinsurance and other supplemental payments from AHCCCS.

PHP subcontracts with hospitals, physicians and other medical providers in Arizona to provide services to its enrollees in Maricopa, Pinal and Gila counties. These services are provided regardless of the actual costs incurred to provide the services. PHP receives reinsurance and other supplemental payments from AHCCCS to cover certain costs of healthcare services that exceed defined thresholds.

Contract with AHCCCS

PHP's current contract with AHCCCS is in the final one-year renewal period of the three-year contract period ended September 30, 2006. This renewal period effectively extends the contract through September 30, 2008. In May 2008, AHCCCS informed PHP that it had been awarded a new contract to provide services to enrollees in the three counties it currently serves plus the following additional six counties: Apache, Coconino, Mohave, Navajo, Pima and Yavapai. The new contract is effective for the three-year period beginning October 1, 2008 and ending September 30, 2011 and includes two one-year renewal options exercisable at the discretion of AHCCCS that, if exercised, would extend the contract to September 30, 2013. The terms of the new contract are similar to the existing contract with the exception of AHCCCS' adoption of a national episodic/diagnostic risk adjustment model that will be applied to health plan specific capitation rates for all non-reconciled risk groups, with further new methodology details to be

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

1. Organization and Operations (continued)

shared with all health plans participating in the AHCCCS program (including PHP) prior to its implementation. AHCCCS also informed each of the health plans of the following about this new model for capitation rate adjustments: (1) for the first year of the new contract (ie., October 1, 2008 to September 30, 2009), AHCCCS will apply approximately 80% of the new capitation rate risk adjustment factor and (2) effective October 1, 2009, AHCCCS will apply the full impact of this new model to the capitation rates. The contract is terminable without cause on 90 days' written notice from AHCCCS or for cause upon written notice from AHCCCS if PHP fails to comply with any term or condition of the contract or fails to take corrective action as required to comply with the terms of the contract. AHCCCS may also terminate the contract with PHP in the event of unavailability of state or federal funding. PHP does not have the ability to terminate the contract without cause. However, PHP may choose not to pursue the two one-year renewal options, subject to payment of certain transition costs.

PHP does not have sufficient information at the current time to estimate the financial impact the new contract will have on its future results of operations or cash flows. Should AHCCCS terminate its contract with PHP, PHP would have to cease operations.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash equivalents include all highly liquid investments with an initial maturity of three months or less when purchased. At various times during the year, PHP's cash and cash equivalents balances exceeded the federally insured limit. Cash and cash equivalents are maintained at high quality financial institutions, and management believes exposure to credit risk is not significant.

AHCCCS Receivables

PHP had approximately \$18,089,000 of receivables due from AHCCCS as of June 30, 2008, including reinsurance reimbursement receivable for amounts paid by PHP for enrollee healthcare services that exceeded maximum limits set forth in its contract with AHCCCS, settlements related to prior period coverage payments (PPC) as discussed further in Note 2 and other supplemental reimbursement receivables. The receivables are determined on an enrollee-specific basis and are stated at net realizable value. PHP writes off 100% of reinsurance receivables related to completed AHCCCS contract years that are more than one-year old.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over the useful life of the assets. The useful lives of PHP's property and equipment range from one year to eight years. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized.

Depreciation expense was approximately \$776,000 for the year ended June 30, 2008, which is included in administrative expenses in the accompanying Statement of Earnings.

Revenues

PHP receives monthly capitation payments under the AHCCCS contract based on the number of enrollees and type of enrollee coverage. Capitation premiums are recognized as revenues in the month in which members are entitled to receive healthcare services as set forth in the AICPA Audit and Accounting Guide, *Health Care Organizations* (the Guide). Included in these monthly payments are capitation amounts applicable to Title XIX Waiver Members. For the contract year ended September 30, 2006, AHCCCS reconciled the Title XIX Waiver Member costs incurred by PHP limiting PHP's related profits and losses to 2% of related capitation revenues (net of administrative expenses and premium taxes), and PHP made its settlement payment to AHCCCS during its fiscal year 2008. During the contract years ended September 30, 2007 and 2008, AHCCCS did not limit the profitability and loss that health plans may recognize for this group of covered enrollees, other than those for which PHP received prior period coverage capitation payments as discussed below. Under the AHCCCS Contract commencing October 1, 2008, AHCCCS will initiate an annual reconciliation process related to the prospective Medical Expense Deduction (MED) population, which includes Title XIX Waiver members whose family income exceeds the limits of all other Title XIX categories and where family medical expenses reduce their family income to or below 40% of the Federal poverty level. This MED reconciliation will limit PHP's profits or losses related to this population to 3% of related capitation revenues (net of administrative expenses and premium taxes) as defined in the applicable AHCCCS contract. For the year ended June 30, 2008, PHP recognized revenues of approximately \$67,948,000 related to Title XIX Waiver Member enrollees, a portion of which represented prospective capitation and a portion of which represented PPC capitation.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

PHP receives capitation payments for PPC separately from its prospective capitation payments. PPC capitation payments are applicable to all types of enrollee coverages in PHP and are intended to cover those healthcare costs incurred by individuals while they are awaiting enrollment in PHP and prior to PHP's ability to manage the healthcare of those enrollees. PHP recognizes PPC revenues in the month in which the healthcare services are provided. AHCCCS limits the profitability and loss that health plans may recognize during the PPC eligibility period to 2% of related capitation revenues (net of administrative expenses and premium taxes) and reconciles the PPC member costs incurred by PHP. For the year ended June 30, 2008, PHP recognized approximately \$26,520,000 of PPC revenues, including PPC settlement estimates. As of June 30, 2008, PHP had a net settlement receivable for PPC costs incurred in excess of PPC payments received of approximately \$7,751,000 for contract years ending September 30, 2007 and 2008, which is included in AHCCCS receivables on the accompanying Balance Sheet.

PHP also receives supplemental payments including 1) delivery premiums to cover the cost of maternity care for qualified members under the federally funded Sixth Omnibus Budget Reconciliation Act (SOBRA) program; 2) one-time hospital premiums for new members who are enrolled while receiving inpatient services and 3) HIV-AIDS premiums to cover the cost of qualifying medications for treatment of enrollees with those conditions. PHP recognizes supplemental revenues during the month in which it determines that healthcare services meeting these criteria have been provided.

Goodwill and Intangible Assets

As of June 30, 2008, PHP had approximately \$79,403,000 of goodwill, which represents the allocation of the excess purchase price paid for PHP's net assets in connection with the Blackstone Group's, Vanguard's primary equity sponsor, purchase of a majority equity interest in Vanguard's parent affiliate on September 23, 2004. The excess purchase price attributable to PHP was determined based upon the fair value of PHP as set forth in an independent appraisal adjusted for income taxes.

As of June 30, 2008, PHP's intangible assets included the AHCCCS contract of \$19,606,000 (net of accumulated amortization of \$11,764,000) and provider network of \$769,000 (net of accumulated amortization of \$461,000). These intangible assets are reviewed for impairment as management becomes aware of impairment indicators.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The AHCCCS contract and the provider network are being amortized over a period of 120 months. Amortization expense of intangible assets was \$3,260,000 for the year ended June 30, 2008 and is estimated to be \$3,260,000 during each of the next five fiscal years.

Goodwill is not amortized but is subject to annual impairment reviews. PHP conducts the annual impairment review during the fourth quarter of each fiscal year by comparing the carrying value of PHP's net assets to the net present value of PHP's future cash flows. If the carrying value exceeds the net present value of future cash flows, an impairment indicator exists and an estimate of the impairment loss is calculated. PHP completed its 2008 annual impairment review noting no impairment. Approximately \$13,100,000 of PHP's goodwill is deductible for tax purposes.

Due from Affiliates

Due from affiliates primarily represents the net excess of funds transferred to the centralized cash management account of Vanguard Health Finance, Inc. (VHF), a wholly owned subsidiary of Vanguard, over funds transferred to or paid on behalf of PHP by VHF. Due from affiliates balances are readily available to PHP for settlement of its current liabilities as they become due.

Generally, this balance is decreased by automatic cash transfers from VHF's centralized cash management account to reimburse PHP's bank accounts for operating expenses and capital expenditures and to pay PHP's fees and services provided by Vanguard Health Management, Inc., including information systems services and other operating expenses, such as payroll, interest and insurance. Generally, the due from affiliates balance is increased through daily cash deposits by PHP to VHF's centralized cash management account. As of June 30, 2008, due from affiliates also included a \$600,000 note receivable from AAHP, an affiliated indirect wholly owned subsidiary of Vanguard and was reduced by \$3,091,000 related to outstanding checks for disbursements by PHP that had not cleared the bank. The note is due and payable on July 31, 2009.

Interest income of approximately \$5,666,000 was earned by PHP on outstanding due from affiliates balances during the year ended June 30, 2008, which is included in other revenues in the accompanying Statement of Earnings. PHP earned interest at an average rate of 3.93% during the year ended June 30, 2008. The interest rate earned approximated the variable portion of the total interest rate paid by Vanguard under LIBOR contracts for its outstanding term loan debt. PHP also earned approximately \$59,000 of interest income on its outstanding cash balances during the year ended June 30, 2008, which is included in other revenues in the accompanying Statement of Earnings.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

PHP incurred interest expense of approximately \$90,000 related to letters of credit fees paid by Vanguard on its behalf during the year ended June 30, 2008, which is included in other revenues in the accompanying Statement of Earnings. The letters of credit collateralize the outstanding performance bonds used to satisfy guaranty requirements set forth by AHCCCS.

Medical Expenses and Reinsurance Proceeds

Monthly capitation payments to primary care physicians and other healthcare providers are expensed in the month services are contracted to be performed as set forth in the Guide. Claims expense for non-capitated arrangements is accrued as services are rendered by hospitals, physicians and other healthcare providers during the year. Contracts between PHP and primary care physicians contain incentives to encourage physicians to practice preventive healthcare. PHP is at risk for hospitalization and medical service claims, including medical compensation and other medical expenses, which exceed its capitation payments from AHCCCS. Medical compensation includes primary care and specialty physician services. Other medical expenses include hospital outpatient services and other ancillary services such as radiology and lab.

PHP is reimbursed by AHCCCS for costs incurred for those enrollees with severe illnesses to the extent such costs exceed \$50,000 per enrollee, except for Title XIX Waiver Group members whose threshold are costs incurred that exceed \$15,000 per enrollee, per AHCCCS contract year. PHP estimates reinsurance recoveries monthly based on reported claims by member and the provisions of the AHCCCS contract. Reinsurance recoveries are deducted from gross medical claims expense on the accompanying Statement of Earnings. PHP is at risk for excess medical costs under reinsurance claims that are disputed and not honored by AHCCCS.

Medical claims payable includes claims received but not paid as well as estimated claims incurred but not reported (IBNR). Medical claims payable is estimated using a combination of historical claims payment data and current cost per member estimates. In order to test the reasonableness of its June 30, 2008 medical claims payable estimate, PHP engaged an actuary to provide an independent estimate of medical claims payable. While management believes that its estimation methodology captures trends in medical claims costs in a timely manner, actual payments could differ significantly from its estimates given changes in the healthcare cost structure or adverse experience.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

Vanguard files consolidated Federal and state income tax returns that include the operating results of PHP. Vanguard allocates taxes to PHP pursuant to the asset and liability method, as if PHP was a separate taxpayer. For balance sheet purposes, such allocations are deducted from due from affiliates in the accompanying Balance Sheet.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, receivables, amounts due from affiliates and payables approximate fair value because of the short maturity of these financial instruments.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Financial statement areas involving significant estimation include reinsurance receivables, PPC settlements and medical claims IBNR. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and will be accounted for in the period identified.

3. Transactions with Affiliates

Affiliates of PHP include healthcare service providers for eligible PHP members that are also affiliated with Vanguard. Medical services provided by these affiliates to eligible PHP members totaled approximately \$19,963,000 during the year ended June 30, 2008. At June 30, 2008, medical claims payable included approximately \$3,100,000 payable to these affiliates for medical services provided to PHP enrollees.

Certain accounting and administrative services and other management services, including payroll, information services, and human resources, among others, were provided by certain other Vanguard subsidiaries. The related fees charged to PHP totaled approximately \$4,653,000 for the year ended June 30, 2008, and are included in administrative expenses in the accompanying Statement of Earnings.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

3. Transactions with Affiliates (continued)

PHP shares certain overhead costs with AAHP including enrollment, claims processing, case management, finance and information technology functions, among others. Allocations of these costs are made between AAHP and PHP using the best information available regarding the utilization of these resources by each entity. The use of other reasonable allocation methods could lead to significantly different results.

4. Commitments and Contingencies

Operating Leases

PHP leases its office facilities and certain equipment under non-cancelable operating leases expiring through August 2010. Lease expense under these leases and miscellaneous rentals totaled approximately \$711,000 for the year ended June 30, 2008, which is included in administrative expenses in the accompanying Statement of Earnings. Future minimum lease payments under non-cancelable operating leases as of June 30, 2008, are approximately as follows.

Years Ending June 30

2009	\$ 667,000
2010	683,000
2011	114,000
Thereafter	—
	<u>\$ 1,464,000</u>

Professional, General and Other Liability Insurance

In the normal course of business, PHP is subject to claims and lawsuits relating to injuries arising from patient treatment and denials thereof. PHP believes that its liability for damages resulting from such claims and lawsuits is adequately covered by insurance and is adequately provided for in its financial statements. PHP's contract with AHCCCS requires that it maintain professional liability insurance, comprehensive general insurance and automobile liability insurance coverage of at least \$1,000,000 for each occurrence. PHP is covered under Vanguard's self-insurance program for professional and general liability claims. For professional and general liability claims incurred from June 1, 2002 through May 31, 2006, Vanguard's wholly owned captive subsidiary insures PHP's professional and general liability risks at a \$10,000,000 retention level.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

4. Commitments and Contingencies (continued)

For claims incurred subsequent to May 31, 2006, Vanguard self-insures the first \$9,000,000 per occurrence, and the captive subsidiary insures the next \$1,000,000 per occurrence. Vanguard carries professional and general liability insurance in excess of its self-insured retention and the captive subsidiary's retention through unrelated commercial insurance carriers for aggregate claims up to \$75,000,000, but limited to annual payments of \$65,000,000 in the aggregate. There is no guarantee that existing coverage will be sufficient for professional and general liability claims either individually or in the aggregate. Professional and general liability insurance expense allocated from Vanguard was approximately \$1,154,000 for the year ended June 30, 2008, and is included in administrative expenses in the accompanying Statement of Earnings.

PHP is covered under Vanguard's self-insurance program for workers' compensation claims. Vanguard maintains coverage for workers' compensation claims exceeding its \$1,000,000 retention level at amounts PHP believes to be adequate. Workers' compensation insurance expense allocated from Vanguard was approximately \$26,000 for the year ended June 30, 2008, and is included in administrative expenses in the accompanying Statement of Earnings.

Vanguard maintains reserves for general and professional liability and workers' compensation risks and makes any necessary claims payments on PHP's behalf. Accordingly, no reserve for liability risks is recorded on the accompanying Balance Sheet. PHP is currently not a party to any such proceedings that, in its opinion, would have a material adverse effect on PHP's business, results of operations or financial position.

Other Claims

PHP is subject to claims and suits arising in the ordinary course of business. Plaintiffs in these matters may request punitive or other damages that may not be covered by insurance. PHP is not aware that it is currently a party to any such proceeding that, in management's opinion, if adversely decided, would have a material effect on PHP's results of operations or financial position.

Subcontracted Services

PHP subcontracts with physician specialists, affiliated hospitals and unaffiliated hospitals to provide covered services to certain patients enrolled in or assigned to PHP on either a capitated or fee-for-service basis.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

4. Commitments and Contingencies (continued)

AHCCCS Plan Compliance

Under PHP's contract with AHCCCS, PHP is required to maintain a performance guaranty. As of June 30, 2008, PHP maintained performance bonds totaling \$22,000,000 to meet this performance guaranty. Vanguard also maintained letters of credit totaling \$2,850,000 on PHP's behalf to collateralize the outstanding performance bonds.

The AHCCCS contract contains certain financial viability standards and performance guidelines that PHP reports on a quarterly and annual basis. These standards and guidelines enable AHCCCS to monitor the financial health of its contracted health plans. PHP must meet the financial viability standards, which include a current ratio requirement of at least one (1.0) and equity per member requirement of at least \$100. As of June 30, 2008, PHP met these financial viability standards.

AHCCCS also monitors certain performance guidelines, which include a medical expense ratio (at least 84%), an administrative cost percentage ratio (no more than 10%) and days outstanding for received but unpaid claims (no more than 30 days for clean claims). AHCCCS does not automatically penalize or sanction health plans that do not meet these guidelines but utilizes these guidelines in combination with other measures to determine the overall operational health and compliance of its contracted health plans. Management believes that PHP operated within the parameters of AHCCCS' administrative cost percentage ratio, days outstanding for received but unpaid claims and medical loss ratio performance guidelines for the year ended June 30, 2008.

PHP is also subject to minimum performance standards for certain clinical quality performance measures under its contract with AHCCCS. In July 2007, AHCCCS notified PHP that it had failed to meet certain of these performance standards. AHCCCS provided PHP a timeframe within which to achieve compliance with or improvement upon these standards or else face monetary sanctions. PHP has implemented processes and procedures to address these standards but is not certain that it will ultimately meet all of these standards when they are re-measured by AHCCCS during 2009. Management believes that possible sanctions would not be material to the financial position, results of operations or cash flows of PHP.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

4. Commitments and Contingencies

Compliance with Laws and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse regulations. Management believes that PHP is in compliance with fraud and abuse regulations as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

5. Income Taxes

Income tax expense allocated to PHP by Vanguard on a separate return basis for the year ended June 30, 2008, consisted of the following.

Current:	
Federal	\$ 13,494,673
State	<u> —</u>
	<u>13,494,673</u>
Deferred:	
Federal	(1,225,941)
State	<u> —</u>
	<u>(1,225,941)</u>
	<u>\$ 12,268,732</u>

Income tax expense allocated to PHP by Vanguard approximated the federal statutory rate for the year ended June 30, 2008.

The tax effects of temporary differences that give rise to deferred tax assets and liabilities are included in due from affiliates in the accompanying Balance Sheet. The due from affiliates balance in the accompanying Balance Sheet is net of approximately \$67,236,000 of cumulative current and deferred income taxes.

VHS Phoenix Health Plan, LLC

Notes to Financial Statements (continued)

6. Retirement Plan

Substantially all employees of PHP, upon qualification, are eligible to participate in Vanguard's defined contribution 401(k) Plan. The 401(k) Plan allows eligible employees to make contributions of 2% to 20% of their annual compensation, subject to annual limitations. Employer matching contributions, calculated as 50% of up to the first 6% of the employee contribution amount, vest 20% after two years of service and continue vesting at 20% per year until fully vested. PHP's matching expense for the year ended June 30, 2008 was approximately \$126,000, which is included in administrative expenses in the accompanying Statement of Earnings.